LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS
200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 7562 **NOTE PREPARED:** Feb 21, 2011
BILL NUMBER: SB 589 **BILL AMENDED:** Feb 21, 2011

SUBJECT: Economic Development and State Tax Matters.

FIRST AUTHOR: Sen. Hershman **BILL STATUS:** 2nd Reading - 1st House
FIRST SPONSOR:

FUNDS AFFECTED: <u>X</u> **GENERAL** **IMPACT:** State & Local
<u>X</u> **DEDICATED**
FEDERAL

<u>**Summary of Legislation:**</u> (Amended) *Interim Study Committee on Economic Development:* The bill makes the Economic Development Study Committee a four-year committee that expires December 31, 2014, with a membership including legislative and nonlegislative members. It requires the study committee to determine methods for eliminating or reducing the personal property tax statewide and the appropriateness of allowing local government the option of eliminating or abating personal property tax for new investment and economic development purposes.

IEDC Reports and Studies: The bill requires the Indiana Economic Development Corporation (IEDC) to collaborate with local economic development organizations and submit an annual report to the study committee regarding collaboration. It requires the IEDC to conduct a statewide study to determine specific economic sectors that should be emphasized by the state and by local economic development organizations within geographic regions in Indiana.

Entrepreneurship Education Programs: The bill requires the State Board of Education, the Commission for Higher Education, and the Department of Workforce Development to work together to develop entrepreneurship education programs for elementary and secondary education, higher education, and individuals in the work force.

Technology and Innovation Commercialization Programs: The bill requires higher education institutions to expand technology and innovation commercialization programs.

Corporate Income Tax Reduction: The bill decreases the Corporate Adjusted Gross Income Tax rate from 8.5% to 6.5% effective July 1, 2012.

Repatriated Foreign Corporate Dividend Deduction: The bill provides an income tax deduction for corporations that repatriate profits from controlled foreign corporations.

Exclusion of Interest on State and Local Bonds: The bill provides that the Adjusted Gross Income Tax and Financial Institutions Tax (for credit unions and investment companies) apply to interest on state and local bonds issued by a state other than Indiana or issued by a political subdivision of such a state.

Sunset of Tax Credits: The bill expires the teacher summer employment income tax credit on January 1, 2012. It specifies that a maternity home tax credit may not be awarded for the providing, after December 31, 2011, of a temporary residence. It provides that a community revitalization enhancement district tax credit may not be awarded for a qualified investment made after December 31, 2011. It provides that a tax credit may not be awarded for making available, after December 31, 2011, a health benefit plan. It also provides that a small employer qualified wellness program tax credit may not be awarded for costs incurred after December 31, 2011.

Net Operating Loss (NOL) Carryback: The bill eliminates the carryback of net operating losses under the adjusted gross income tax.

Attribution of Business Income to Indiana: The bill clarifies the attribution rules applicable to business income and sales receipts from certain intangibles under the adjusted gross income tax. It provides that the Department of State Revenue must contract for advice and recommendations concerning the proper distribution, apportionment, or allocation of income and deductions among two or more businesses.

Sales Tax Exemption for Utility Expenditures: The bill provides that a claim for a sales tax refund must be filed within one year if the claim is based on the predominant use of electrical energy, natural or artificial gas, water, steam, and steam heat by certain businesses or based on the sales tax exemption for these services or commodities.

Sales Tax Collection Allowance for Certified Service Providers: The bill permits the Department of State Revenue to negotiate a collection allowance for the collection of sales taxes by an out-of-state seller.

Delaware County Community Revitalization Enhancement Districts (CREDs): The bill removes restrictions on activating a third CRED in Delaware County. The bill caps the total amount of state taxes annually captured by the three Delaware County CREDs at $2,000,000. It also repeals statutes prohibiting the activation of a third community revitalization enhancement district in Delaware County.

New Community Revitalization Enhancement Districts (CREDs): It specifies certain requirements for the designation of any CRED after December 31, 2010.

Redevelopment Financing: The bill permits local governments to pledge revenue from the County Adjusted Gross Income Tax and the County Economic Development Income Tax for redevelopment financing

Regional Development Authorities: The bill provides that if a county or a municipality becomes a member of a regional development authority (other than the Northwest Indiana Regional Development Authority) after June 30, 2011, and before July 1, 2013, the amount of money that must be transferred annually by the county or municipality is equal to the amount that would be distributed to the county or the municipality from a county economic development income tax rate of 0.025%.

Other: The bill removes outdated individual income tax adjustments. It extends the time in which a person must file an amended Indiana adjusted gross income tax return to reflect modifications made in a federal income tax return. It prohibits the Department of State Revenue from taking an action to collect a delinquent tax until the later of the time to file a tax appeal has expired or a final decision is made in a tax appeal. It expands the power of the Tax Court. It makes related changes to obtaining injunctions against the collection of a tax. It also removes outdated individual income tax adjustments.

Effective Date: Upon passage; January 1, 2011 (retroactive); July 1, 2011; January 1, 2012; July 1, 2012.

Explanation of State Expenditures: *Interim Study Committee on Economic Development:* The bill establishes the Interim Study Committee on Economic Development for four years until the end of 2014. The Committee will consist of 17 members as follows: two Senators, two Representatives, the CEO of the Indiana Economic Development Corporation (IEDC) or the CEO's designee, four members appointed by the Governor, four members appointed by the President Pro Tempore of the Senate, and four members appointed by the Speaker of the House of Representatives. During the 2010 interim, the Legislative Council provided $16,000 budgets for interim study committees with 16 or more members, including for the Interim Study Committee on Economic Development which was structured the same as in this bill. The Committee held two meetings in Indianapolis, one meeting in Anderson, and one meeting in West Lafayette at a total cost of $6,355.

The Committee is to operate under the policies governing study committees adopted by the Legislative Council. The Committee must issue a final report before November 1st each year to the Legislative Council containing any findings and recommendations of the Committee.

This bill specifies that the Committee study the following topics during each interim:
(1) best practices in state and local economic development policies and activities;
(2) the use and effectiveness of tax credits and deductions;
(3) whether there are any specific sectors of the economy for which Indiana might have comparative advantages over other states;
(4) the extent to which Indiana's tax laws encourage business investment and any improvements that might be made to Indiana's tax laws;
(5) the extent to which Indiana's education systems support economic development;
(6) the benefits of existing CREDs and possible new CREDs as an economic development tool;
(7) methods for eliminating or reducing the personal property tax statewide and the appropriateness of allowing local government the option of eliminating or abating personal property tax for new investment and economic development purposes.
(8) any other issue assigned to the Committee by the Legislative Council or as directed by the Committee's Co-Chairs.

IEDC Reports and Studies: The bill requires the IEDC to collaborate with local economic development organizations and submit an annual report to the Interim Study Committee on Economic Development concerning collaborative efforts. The IEDC is also required to conduct a statewide study to determine economic sectors that should be emphasized within geographic regions in Indiana. These provisions may increase expenses for the IEDC, but should be able to be accomplished within the IEDC's existing resources.

Entrepreneurship Education Programs: The bill requires the State Board of Education, the Commission for Higher Education (CHE), and the Department of Workforce Development to develop entrepreneurship education programs for elementary and secondary education, higher education, and individuals in the work force. This provision should be able to be accomplished within the existing resources available to the State Board of Education, the CHE and the DWD.

Technology and Innovation Commercialization Programs: This bill requires higher education institutions to expand technology and innovation commercialization programs. State educational institutions may need to reallocate resources from other programs or areas to meet this requirement.

Department of State Revenue (DOR) The Department of State Revenue (DOR) will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the changes made by the bill. The bill would also increase administrative expenditures by the DOR by requiring the DOR to adopt rules to establish standards for granting monetary allowance to certified service providers and sellers. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Summary:* The bill makes the following changes in 2012: (1) reduces the Corporate Adjusted Gross Income (AGI) tax rate from 8.5% to 6.5%; (2) eliminates the exclusion for individual and corporate taxpayers for interest income from state and local bonds; and (3) eliminates certain tax credits. The fiscal impact of these changes would begin in FY 2013. The table below reports the net impact on state revenue from these changes. The offset from elimination of tax credits assumes future credits on expenditures or investment made after 2011 would on average be consistent with credits claimed in recent years.

Net Impact (in millions)	
Provision	**FY 2013**
Corporate AGI Tax Rate Reduction	(76.3)
Elimination of Interest Exclusion	65.9
Elimination of Tax Credits	3.1
Total	**(7.3)**

Corporate Income Tax Reduction: The bill reduces the corporate AGI tax rate from 8.5% to 6.5% effective July 1, 2012. The estimated revenue loss from this rate reduction is estimated at $76.3 M in FY 2013. The revenue loss from the rate reduction could potentially increase by an average of 1% to 2% per year after FY 2013.

Revenue from the corporate AGI Tax is distributed to the state General Fund. The revenue loss estimate is based on the Revenue Technical Committee forecast (December 15, 2010) for the corporate AGI tax.

Exclusion of Interest on State and Local Bonds: The bill eliminates the exclusion of interest income from state and local bonds (except those issued by Indiana or Indiana local governments) from: (1) the individual AGI tax; (2) the corporate AGI tax; (3) and the FIT as it applies to credit unions and investment companies. (Note: Under current statute, financial institutions other than credit unions and investment companies pay tax on interest from state and local bonds, including Indiana state and local bonds.) This change is effective beginning in tax year 2012, so the revenue gain from the change will likely commence in FY 2013. The total revenue gain in FY 2013 is estimated at $65.9 M, with $38.1 M coming from individual taxpayers and $27.8

M coming from corporate taxpayers. The revenue yield from this change could potentially grow by an average of about 3% to 4% per year after FY 2013.

(Revised) *Repatriated Foreign Corporate Dividend Deduction:* Under the bill, certain dividends received by a U.S. corporation from a controlled foreign corporation are eligible for up to a 100% dividends-received deduction beginning in tax year 2012. The deduction percentage must be approved by the IEDC. The deducted dividends also must be invested in Indiana under a reinvestment plan approved by both the corporate taxpayer and the IEDC. At the taxpayer's election, the deduction is available for dividends received either: (1) during the taxpayer's taxable year that begins in the year the deduction is approved by the IEDC; or (2) during the taxpayer's taxable year that begins in the year after the year the deduction is approved by the IEDC.

The deduction is also subject to a couple of other limitations. First, the deduction applies only to dividends in excess of the taxpayer's "Olympic" average dividend level over three of the five most recent taxable years. Second, the amount of dividends eligible for the deduction is limited to the <u>greater</u> of: (1) $1M; (2) the amount of earnings shown as permanently reinvested outside the United States on the taxpayer's most recent audited financial statement; or (3) the tax liability shown as attributable to earnings described in (2) divided by the corporate AGI tax rate. If the financial statement fails to show amounts described in (2) and (3), they will be treated as equal to zero and the deduction may equal up to $1 M.

The impact of this provision is unknown. Absent a similar deduction under the Federal Corporate Income Tax (which has an average tax rate of roughly 26% to 27% and a top marginal tax rate of 35%) it would appear that corporations would be unwilling to subject such dividends to the Federal tax in order to receive an 8.5% deduction (or 6.5% under the tax rate reduction in this bill) on the Indiana corporate tax. In the event that dividends are repatriated under this provision, there would be no negative impact on state revenue since the deductible dividends would have to exceed the normal dividends received by the corporate taxpayer. This also assumes that these "excess" dividends would not otherwise be repatriated and invested in Indiana.

Sunset of Tax Credits: The bill sunsets the income tax credits as described below. The two tables following the explanation of the credit provisions report the number of individual and corporate taxpayers claiming each credit in 2006, 2007, and 2008, and the total credit amount claimed each year. The average annual total credits claimed under these tax credits during the 3-year period was about $3.1 M.

(1) <u>Teacher Summer Employment Compensation Credit:</u> The bill eliminates the tax credit after December 31, 2011. This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer employing a teacher in a qualified position during school summer recess. The credit is equal to the lesser of 50% of the compensation paid to the teacher during the taxable year or $2,500.

(2) <u>Maternity Home Tax Credit:</u> The bill prohibits the tax credit from being awarded for providing residence in a maternity home after December 31, 2011. This is a nonrefundable tax credit that may be claimed by a taxpayer owning and operating a registered maternity home that provides a temporary residence for at least 60 days to an unrelated pregnant woman. The maximum credit is $3,000 for a taxable year. Total credits awarded during any state fiscal year is limited to $500,000.

(3) <u>Community Revitalization Enhancement District (CRED) Tax Credit:</u> The bill prohibits the tax credit from being awarded for investment made after December 31, 2011. This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer making qualified investment for the redevelopment or rehabilitation of property located within a CRED. The credit is equal to 25% of the qualified investment

during the taxable year.

(4) Credit for Offering Health Benefit Plans: The bill prohibits the tax credit from being awarded for the provision of a health benefit plan after December 31, 2011. This is a nonrefundable tax credit that may be claimed in each of the first two years that an employer makes a health benefit plan available to employees. The credit is equal to $50 per employee enrolled in the employer's health benefit plan, up to a maximum of $2,500 per year in each of the first two years the plan is offered. An employer claiming the credit must offer health insurance for at least 24 consecutive months after the taxable year in which the health benefit plan is initially offered.

(5) Small Employer Qualified Wellness Program Credit: The bill prohibits the tax credit from being awarded for wellness program costs incurred after December 31, 2011. This is a nonrefundable tax credit that may be claimed by an employer providing a qualified employee wellness program certified by the Indiana State Department of Health. The tax credit is equal to 50% of the cost incurred by the taxpayer to provide the wellness program during the taxable year.

Individual Income Taxpayers	**2006**	**2007**	**2008**
Teacher Summer Employment Compensation Credit			
Taxpayers Claiming Credit	22	21	19
Credits Claimed	$11,917	$15,855	$9,199
Maternity Home Tax Credit			
Taxpayers Claiming Credit	15	13	8
Credits Claimed	$6,615	$4,718	$2,056
Community Revitalization Enhancement District Tax Credit			
Taxpayers Claiming Credit	84	55	77
Credits Claimed	$54,228	$416,447	$152,445
Credit for Offering Health Benefit Plans*			
Taxpayers Claiming Credit		214	218
Credits Claimed		$137,189	$155,466
Small Employer Qualified Wellness Program Credit*			
Taxpayers Claiming Credit		83	170
Credits Claimed		$81,631	$180,758
*Effective beginning in tax year 2007.			

Corporate Income Taxpayers	2006	2007	2008
Teacher Summer Employment Compensation Credit			
Taxpayers Claiming Credit	N/R	N/R	N/R
Credits Claimed	$2,500	$2,500	$2,500
Maternity Home Tax Credit			
Taxpayers Claiming Credit	0	0	0
Credits Claimed	$0	$0	$0
Community Revitalization Enhancement District Tax Credit			
Taxpayers Claiming Credit	N/R	N/R	N/R
Credits Claimed	$3,224,231	$2,663,171	$1,697,748
Credit for Offering Health Benefit Plans*			
Taxpayers Claiming Credit		N/R	N/R
Credits Claimed		$2,550	$50
Small Employer Qualified Wellness Program Credit*			
Taxpayers Claiming Credit		9	20
Credits Claimed		$20,681	$50,030
N/R=Five or fewer filers, filer count not reported. *Effective beginning in tax year 2007.			

Net Operating Loss (NOL) Carryback: The bill eliminates carry back of NOL by individual and corporate taxpayers beginning in tax year 2012. This change could potentially reduce carry back usage in the long run by business taxpayers, provided they are not able to deduct as much NOL over time without carry back. More likely, this change will not increase the amount of income tax paid in the long run by businesses with NOL, since NOL not deducted in the year it is incurred could still be carried forward for 20 years. However, eliminating carry back of NOL would prevent business taxpayers from using NOL incurred during recessionary periods to obtain immediate refunds by amending returns and deducting these NOL amounts against tax liabilities for the year or two immediately preceding the recession.

Current statute allows a business that pays the corporate adjusted gross income (AGI) tax or the individual AGI tax to deduct from AGI the net operating loss (NOL) the business incurs during the taxable year. If the business's AGI during the taxable year is not sufficient to deduct all the NOL, the business may: (1) carry back the excess NOL and deduct it from the business's AGI during the two preceding taxable years; or (2) carry forward the excess NOL and deduct it from the business's AGI during subsequent tax years for up to 20 years.

While data is available (reported below) showing the amount of NOL claimed annually by individual and corporate taxpayers, the amount of NOL carried back cannot be distinguished.

	NOL Deduction Amount			
Year	Individual Taxpayers		Corporate Taxpayers	
	Filers	Deduction Amount (millions)	Filers	Deduction Amount (millions)
2000	4,577	$329.8	6,056	861.1
2001	3,938	279.2	5,532	655.0
2002	4,112	311.8	5,625	1,082.5
2003	6,003	338.2	7,055	1,095.2
2004	5,290	309.0	7,564	2,064.8
2005	5,934	284.8	6,960	3,566.8
2006	6,602	202.6	8,450	9,688.6
2007	6,938	409.9	8,319	7,993.4
2008	6,885	432.5	7,405	6,025.8

Attribution of Business Income to Indiana: (1) The bill contains two provisions relating to the attribution of business income to Indiana.

(1) The bill clarifies the attribution rules applicable to business income and sales receipts from certain intangibles under the adjusted gross income tax in lieu of current statute that provides specific conditions under which income and receipts from intangible property are attributable to Indiana. The provision responds to the Tax Court's decision in Riverboat Development, Inc. v. Indiana Department of State Revenue (Cause No. 49T10-0506-TA-52), February 22, 2008. In this case, the Tax Court decided that income received by a by a non-Indiana pass through entity from its interest in an Indiana pass through entity is, under current statute, not taxable income for purposes of the adjusted gross income tax. Under the provision, it is expected that income in such circumstances would be attributable to Indiana and taxable under the adjusted gross income tax. This provision could potentially prevent additional revenue loss under current income attribution rules. The amount of revenue loss that might be prevented is indeterminable.

(2) The bill specifically requires the Department of State Revenue (DOR) to contract for advice and recommendations concerning the proper distribution, apportionment, or allocation of income and deductions among two or more businesses. DOR is currently considering contracting for assistance in auditing corporate taxpayers relative to transfer pricing schemes being implemented by these taxpayers as a means of allocating cost of overhead or centralized services to related corporate entities. The revenue collected from evaluating these transfer pricing schemes is indeterminable but could be significant.

Sales Tax Exemption for Utility Expenditures: Under current statute, transactions involving electrical energy, natural or artificial gas, water, steam and steam heat are exempt from Sales Tax if the person acquiring the energy uses it in the direct production of goods. The bill provides that a refund claim based on this exemption may not cover transactions that occur more than 12 months before the date of the refund claim. By restricting the time period that refunds could be claimed, this bill could potentially result in an indeterminable decrease in the amount of Sales Tax refunds claimed. Any impact however is expected to be minimal.

Sales Tax Collection Allowance for Certified Service Providers: The bill provides that the DOR may negotiate with a certified service provider or seller to provide monetary allowance that is greater than the Sales Tax collection allowance provided in IC 6-2.5-6-10 for the collection of Sales or Use Tax on sales, leases and rentals of goods and services made in a state that is member of the Streamlined Sales and Use Tax Agreement (SSUTA) or a jurisdiction that is not a member state. [A certified service provider is an agent certified jointly by the states that are signatories to the SSUTA agreement to perform all of the seller's sales tax functions].To the extent that this provision leads to more compliance in Use Tax being paid on out-of - state transactions, revenue collected from Sales and Use Tax would increase. The extent of the increase is currently indeterminable.

Under current statute, all tangible personal property purchased out-of state is subject to a Use Tax. A person must pay the use tax directly to the State on the Income Tax form.

(Revised) *Delaware County Community Revitalization Enhancement Districts (CREDs)*: The bill makes the following two changes relating to Delaware County.

(1) The bill changes the limitation on the amount of incremental sales and income tax revenue that can be captured in the three Delaware County CREDs. Currently, Delaware County has three CREDs (Magna, ABB, and the BorgWarner plant), but current statute only allows two of the three to capture tax revenue up to $1 M per year each. The bill changes this limit to $2 M annually applicable to the combined revenue capture by all three CREDs. This change could potentially increase the annual revenue capture by the Delaware County CREDs provided that capture amounts would be less than $2 M per year in any two of the CREDs. Distributions of captured tax revenue to the Magna CRED totaled $77,227 in FY 2006; $248,330 in FY 2007; $299,829 in FY 2008; and $247,228 in FY 2009. Revenue has not been captured by the ABB or the BorgWarner CREDs.

(2) The bill repeals a limit on the application of the CRED tax credit in the ABB and BorgWarner CREDs. Current statute provides that the CRED tax credit applies only to investment made in the CRED (ABB or BorgWarner) in which income and sales tax capture is allowed. The impact of this change is indeterminable. The change would be effective only through the end of 2011 when the CRED tax credit is eliminated under this bill.

(Revised) *New Community Revitalization Enhancement Districts (CREDs)*: The bill establishes local economic distress and site requirements that must be met for an new CRED to be established after December 31, 2010. Under the bill, an advisory commission on industrial development is prohibited from designating a CRED under current statutes allowing CREDs in specific local units, and a county or municipal council is prohibited from designating a CRED under current statutes allowing CREDs in first and second class cities, unless the body makes the following findings:

(1) The average selling price of homes in the county or municipality has declined by 14% over a one year period within 4 years of the designation;
(2) The unemployment rate was at least 10.4% in a calendar month in the year preceding the designation;
(3) The proposed CRED contains a site suitable for revitalization that: (a) has a vacant industrial building of at least 1.3 M square feet of space; (b) the building contains at least 80,000 square feet of office space; (c) the site contains a reinforced pad suitable for expansion of at least 200,000 square feet; (d) the site is serviced by water treatment facility capable of treating all of the effluent discharged from the site; and (e)

the site consists of at least 120 acres of land.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Exclusion of Interest on State and Local Bonds:* By eliminating the exclusion for interest income from state and local bonds (except those issued by Indiana or Indiana local governments), the would significantly increase taxable income. Consequently, some counties imposing local option income taxes could potentially experience a substantial increase in revenue from these taxes. Based on the current average LOIT rate of about 1.3%, LOIT collections on a statewide basis could potentially increase by about $14.6 M annually. The distribution of this revenue gain across counties is unknown, however.

Redevelopment Financing: This bill would allow local governments to utilize certified shares from CAGIT or distributions from CEDIT for redevelopment financing. Current statute allows distributive shares of the county option income tax (COIT) to be used for this purpose. Any impact would depend upon local action.

Regional Development Authorities: The bill provides that counties or municipalities forming regional development authorities during FY 2012 and FY 2013 will receive transfers equal to the amount that would be distributed from a CEDIT rate of 0.025%. Current statute provides that members of regional development authorities will receive transfers equal to the amount that would be distributed from a CEDIT rate of 0.05%.

Currently, the Northwest Indiana Regional Development Authority is the only regional development authority in Indiana.

State Agencies Affected: DOR; IEDC; State Board of Education; CHE; DWD; State educational institutions.

Local Agencies Affected: Counties with local option income taxes. Counties and second class cities establishing regional development authorities. Delaware County CREDs.

Information Sources: OFMA Income Tax databases, 2000-2008. Gruber, J. and Rauh, J. (2007). *How elastic is the corporate income tax base?* Bruce, D., Deskins, J., and Fox. W. (2005) *On the Extent, Growth, and Efficiency Consequences of State Business Tax Planning*. Bruce, D. Deskins, J., and Fox, W. (2006). *On The Relative Distortions of State Sales, Corporate Income and Personal Income Taxes*.U. S. Census Bureau, *State and Local Government Finances* databases, 1998-2008. U. S. Internal Revenue Service, Statistics of Income Division, *Annual Analysis of Individual Income Tax Returns*, *SOI Bulletins*, Fall 2002-Fall 2010. U. S. Congress, Joint Committee on Taxation, Annual *Estimates of Federal Tax Expenditures* reports, 2008-2010. U. S. Internal Revenue Service, Statistics of Income Division, Annual Corporate and Individual Tax Stats Tables. Tom Conley; DOR; 317-232-8039.

Fiscal Analyst: Jim Landers, 317-232-9869; Jessica Harmon, 317-232-9854; Diana Agidi, 317-232-9867.